

Individual Income Tax Returns, 1996: Early Tax Estimates

by Shawn M. Harwood and Maureen Keenan Kahr

Early estimates for Tax Year 1996, based on individual income tax returns filed through April 1997, indicate that the growth of both adjusted gross income (AGI) and taxable income grew more than twice as much as the inflation rate. Moderate growth in salaries and wages contributed to the 6.6-percent increase in AGI for 1996, which rose from \$3,727.7 billion to \$3,972.4 billion. Taxable income grew 7.9 percent to \$2,629.6 billion, and total income tax grew 9.0 percent to \$539.0 billion for 1996. The earned income credit (EIC) for 1996 grew 13.3 percent, increasing from \$24.9 billion for 1995 to \$28.2 billion for 1996. The continued growth in EIC may be attributed primarily to the final “phase-in” of tax legislation, as well as to indexing for inflation. For the 1996 filing period, traditional “paper” methods of filing (Forms 1040, 1040A, and 1040EZ) declined 4.5 percent, while Form 1040PC and electronic methods of filing rose a combined 24.6 percent.

Data for this article were derived from the “Early Tax Estimates” (or ETE) subset of returns included in the full sample used for *Statistics of Income--Individual Income Tax Returns* for 1996. Designed to provide estimates as soon as possible following the close of the regular tax return filing season, the 1996 ETE sample was extracted from the subset of returns filed through the end of April 1997. With a sample size of 21,297 returns, the ETE sample is small in comparison to the estimated 124,000 individual income tax returns that will comprise the final Statistics of Income (SOI) sample. While 1996 represents the fifth time this sample has been used to generate early tax estimates, the taxpayers included in the ETE subsample have been part of the SOI sample each year they filed a return since Tax Year 1979.

A comparison of the ETE sample data to the full-year, final SOI sample data provides insight into the relative accuracy of the ETE sample. Figure A correlates early estimates of key income and other items to the data generated in the final SOI sample for Tax Year 1995. For many elements, such as unemployment compensation and total earned income credit, the ETE sample of returns provides relatively reliable estimates. For other items, however, the ETE sample estimates are less reliable. These elements include partnership, S Corporation, and sole proprietorship (business) net income or loss; capital gains reported on Schedule D; and the alternative minimum tax. Often

reported in sizable but varying amounts, these items commonly appear on returns filed after April. Most of these returns used filing extensions, and many of them are filed by high-income taxpayers. As a result, early tax estimates for these items (and for high-income returns in general) should be used with caution.

The estimates from high-income returns are also subject to relatively high sampling variability. Since the ETE subset of returns is not stratified to favor high-income taxpayers, there may be an insufficient number of high-income returns filed through April for ETE to accurately represent this portion of the individual income tax return population. The discussion that follows, therefore, focuses only on those tax return items and those taxpayer characteristics for which the ETE sample is believed to offer reliable estimates. Also, comparisons of data between Tax Years 1995 and 1996 in this article use the early tax estimates for both years [1].

Selected Sources of Income and Statutory Adjustments

Early estimates of adjusted gross income (AGI) indicate a 6.6-percent growth to \$3,972.4 billion for 1996, a slightly larger growth than for the previous year (Figure B). This growth outpaced the 3.0-percent annual rate of inflation for 1996 [2]. Salaries and wages increased 2.3 percent from \$2,970.1 billion to \$3,039.9 billion for 1996.

The principal components of AGI and statutory adjustments to AGI are shown in Tables 2 and 3, respectively. One of the most noteworthy increases among other sources of income for 1996 was a 38.3-percent annual increase in capital gain distributions reported on the Form 1040, up from the 30.8-percent growth of the previous year [3]. The number of returns reporting capital gain distributions grew 11.2 percent. The notable growth in the amount of capital gain distributions reported on the Form 1040 for both 1995 and 1996 may reflect an increased level of investment in mutual funds by investors who have no other capital gains and thus no need to file Schedule D.

Taxable interest increased 9.8 percent to \$135.6 billion, in spite of consistently low interest rates during most of 1996 [4]. These lower interest rates may be responsible for the diminished growth rate of taxable interest relative to its 12.9-percent growth for 1995. Growing 17.4 percent, taxable individual retirement arrangement (IRA) distributions represented another major growth in reported income for 1996. Further, 1996 Social Security benefits in adjusted gross income grew 12.0 percent to \$43.7 billion. Taxable pensions, constituting the second largest

Shawn M. Harwood and Maureen Keenan Kahr are economists with the Individual Statistics Branch. This article was prepared under the direction of Carl Greene, Chief, Individual Research Section.

Individual Income Tax Returns, 1996: Early Tax Estimates

Figure A

Comparison of Selected Early Tax Estimates (ETE) Data and Final Statistics of Income (SOI) Data, Tax Year 1995

[Number of returns is in thousands--money amounts are in millions of dollars]

Item ¹	1995 ETE ^{2,3}	1995 final SOI data ⁴	Percentage increase, ETE to final SOI data
	(1)	(2)	(3)
Number of returns.....	110,587	118,218	6.9
Adjusted gross income (less deficit).....	3,727,681	4,189,354	12.4
Salaries and wages.....	2,970,095	3,201,457	7.8
Taxable interest.....	123,558	154,781	25.3
Dividends.....	99,449	94,592	-4.9
Business or profession income:			
Net income.....	110,368	191,810	73.8
Net loss.....	12,696	22,466	77.0
Sales of capital assets reported on Schedule D:			
Net gain.....	83,528	176,473	111.3
Net loss.....	7,600	9,715	27.8
Capital gain distributions reported on Form 1040.....	3,983	3,657	-8.2
Individual Retirement Arrangement (IRA) distributions in adjusted gross income.....	33,852	37,316	10.2
Pensions and annuities in adjusted gross income.....	203,625	221,053	8.6
Rent and royalty:			
Net income.....	30,551	39,679	29.9
Net loss.....	18,249	25,795	41.3
Partnership and S Corporation:			
Net income.....	83,970	166,419	98.2
Net loss.....	16,124	40,666	152.2
Farm:			
Net income.....	6,571	8,192	24.7
Net loss.....	11,858	16,042	35.3
Unemployment compensation.....	18,191	19,336	6.3
Social Security benefits in adjusted gross income.....	39,005	45,715	17.2
Other income:			
Net income.....	17,270	26,977	56.2
Net loss ⁵	11,509	52,923	359.8
Total statutory adjustments.....	30,030	41,140	37.0
Payments to self-employed (Keogh) retirement plans.....	4,971	8,734	75.7
Total itemized deductions.....	448,222	527,374	17.7
Taxable income.....	2,438,148	2,813,826	15.4
Total tax credits ⁶	7,090	10,040	41.6
Total earned income credit ⁷	24,879	25,956	4.3
Total income tax ⁸	494,663	588,419	19.0
Alternative minimum tax.....	532	2,291	330.6

¹ All items are money amounts except for the number of returns.

² Data are based on a simple random sample of returns filed through April 1996.

³ 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

⁴ Data are based on a stratified random sample of returns filed through December 1996 and will be published in Statistics of Income--1995, Individual Income Tax Returns (in preparation).

⁵ Consists of all losses (including net operating losses) reported on Form 1040, line 21, except the foreign earned income exclusion.

⁶ Includes earned income credit used to reduce total income tax to zero.

⁷ Includes earned income credit used to reduce total income tax to zero, plus the amount used to offset any additional taxes; plus the refundable portion.

⁸ Total income tax is the sum of income tax after credits and alternative minimum tax, less the total earned income credit as reported on the tax return (if the result was negative, total income tax was made equal to zero).

Individual Income Tax Returns, 1996: Early Tax Estimates

Figure B

Comparison of Total and Selected Sources of Income and Statutory Adjustments, Tax Years 1995 and 1996

[Number of returns is in thousands--money amounts are in millions of dollars]

Item	1995 ETE ^{1,2}		1996 ETE ¹		Percentage increase in amount
	Number of returns	Amount	Number of returns	Amount	
	(1)	(2)	(3)	(4)	(5)
Adjusted gross income (less deficit).....	110,587	3,727,681	111,694	3,972,391	6.6
Total income or loss ³	110,587	3,757,711	111,694	4,002,942	6.5
Salaries and wages.....	95,770	2,970,095	96,391	3,039,872	2.3
Taxable interest.....	61,752	123,558	60,783	135,620	9.8
Capital gain distributions reported on Form 1040.....	4,316	3,983	4,800	5,508	38.3
Individual Retirement Arrangement (IRA) distributions in adjusted gross income...	4,760	33,852	5,267	39,738	17.4
Pensions and annuities in adjusted gross income.....	17,424	203,625	18,167	211,419	3.8
Social Security benefits in adjusted gross income	5,699	39,005	6,321	43,699	12.0
Less: total statutory adjustments.....	14,867	30,030	15,121	30,551	1.7
Individual Retirement Arrangement (IRA) payments.....	4,071	7,682	3,961	7,549	-1.7
Self-employed health insurance deduction.....	2,105	1,799	2,102	1,802	0.2

¹ Data are based on the Early Tax Estimates (ETE) subsample of returns used for Statistics of Income--Individual Income Tax Returns.

² 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

³ Includes income not shown separately below.

NOTE: All data are for returns filed through April.

portion of total income, grew 3.8 percent to \$211.4 billion for 1996.

Statutory adjustments, which reduce adjusted gross income, increased by just 1.7 percent to \$30.6 billion for 1996. Continuing the downward trend begun in Tax Year 1986, payments to Individual Retirement Arrangements fell 1.7 percent to \$7.5 billion [5].

Itemized Deductions

For 1996, both the number of taxpayers itemizing deductions and the amounts they claimed increased (Figure C). The number of returns with itemized deductions increased 1.4 percent to 30.6 million, while total itemized deductions grew 7.9 percent to \$483.9 billion from \$448.2 billion for 1995.

Figure C

Returns with Itemized Deductions: Comparison of Adjusted Gross Income and Selected Itemized Deductions, Tax Years 1995 and 1996

[Number of returns is in thousands--money amounts are in millions of dollars]

Item	1995 ETE ^{1,2}		1996 ETE ¹		Percentage increase in amount
	Number of returns ³	Amount	Number of returns ³	Amount	
	(1)	(2)	(3)	(4)	(5)
Adjusted gross income.....	30,171	2,143,357	30,587	2,333,011	8.8
Total itemized deductions..... ⁴	30,171	448,222	30,587	483,853	7.9
Taxes paid deduction.....	29,763	161,187	30,139	167,950	4.2
Total interest paid deduction..... ⁵	25,286	182,342	25,855	190,246	4.3
Home mortgage interest:					
Paid to financial institutions.....	24,476	170,549	25,194	180,753	6.0
Paid to individuals.....	1,805	5,055	1,685	5,204	2.9

¹ Data are based on the Early Tax Estimates (ETE) subsample of returns used for Statistics of Income - Individual Income Tax Returns.

² 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

³ Returns with no adjusted gross income are not included in the deduction counts. For this reason, the sum of returns with total itemized deductions after limitation and returns with total standard deductions is less than the total number of returns for all filers.

⁴ Includes deductions, not shown separately below.

⁵ Includes deductible points and "investment interest" expense, not shown separately.

NOTE: All data are for returns filed through April.

Individual Income Tax Returns, 1996: Early Tax Estimates

Figure D

Comparison of Adjusted Gross Income, Taxable Income, and Total Income Tax, Tax Years 1995 and 1996

[Number of returns is in thousands--money amounts are in millions of dollars]

Item	1995 ETE ^{1,2}		1996 ETE ¹		Percentage increase in amount
	Number of returns	Amount	Number of returns	Amount	
	(1)	(2)	(3)	(4)	(5)
Adjusted gross income (less deficit).....	110,587	3,727,681	111,694	3,972,391	6.6
Total itemized deductions.....	30,171	448,222	30,587	483,853	7.9
Standard deductions ³	79,610	395,322	80,224	407,359	3.0
Total exemptions.....	100,395	542,219	101,100	553,664	2.1
Taxable income.....	88,657	2,438,148	89,147	2,629,590	7.9
Income tax before credits.....	88,549	501,221	89,066	545,382	8.8
Total tax credits ⁴	14,051	7,090	14,595	7,977	12.5
Child care credit.....	5,457	2,330	5,541	2,318	-0.5
Earned income credit used to offset income tax before credits ⁵	7,650	3,028	8,062	3,542	17.0
Total income tax ⁶	83,453	494,663	83,564	538,991	9.0
Income tax after credits.....	83,446	494,132	83,564	537,405	8.8
Alternative minimum tax.....	227	532	318	1,586	198.1

¹ Data are based on the Early Tax Estimates (ETE) subsample of returns used for Statistics of Income--Individual Income Tax Returns.

² 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

³ Includes both the regular standard deduction and any additional standard deduction for age 65 or over or for blindness.

⁴ Includes earned income credit used to offset income tax before credits.

⁵ For SOI tabulations, the earned income credit is divided into three parts: an amount used to offset income tax before credits (limited to the amount needed to reduce income tax after credits to zero); an amount used to offset all other taxes (limited to the amount needed to reduce total tax liability to zero); and a refundable portion (the excess of credit over total taxes).

⁶ The number of returns with total income tax is less than the sum of returns with income tax after credits and returns with alternative minimum tax because some returns reported both. Total income tax is the sum of income tax after credits and alternative minimum tax, less the total earned income credit as reported on the tax return (if the result was negative, total income tax was made equal to zero).

NOTE: All data are for returns filed through April.

The largest itemized deduction for 1996, the interest paid deduction, rose 4.3 percent to \$190.2 billion. The largest component of this deduction, home mortgage interest paid to financial institutions, grew 6.0 percent, from \$170.5 billion for 1995 to \$180.8 billion for 1996. The second largest itemized deduction, taxes paid, rose 4.2 percent for 1996, reaching nearly \$168.0 billion. Table 4 presents additional data on itemized deductions, classified by size of AGI.

Taxable Income and Total Income Tax

For 1996, taxable income grew by 7.9 percent to \$2,629.6 billion (Figure D). This was the fourth consecutive year for which taxable income not only grew, but grew at a faster rate than the previous year. The 7.9-percent growth in taxable income exceeded the 6.6-percent growth in AGI; part of this difference was due to the fact that income increased at a faster rate than inflation-adjusted amounts for standard deductions and for deductions for personal exemptions. Although itemized deductions rose 7.9 percent, this increase was still not large enough to offset the smaller percentage increase in the standard and personal exemption amounts. The 1996 ETE sample indicates a 9.0-percent growth in total income tax, from

\$494.7 billion to \$539.0 billion [6]. This increase represents the largest annual growth rate since the ETE study began in Tax Year 1992.

Earned Income Credit and Other Tax Credits

Approximately 19.1 million taxpayers claimed the earned income credit (EIC) for Tax Year 1996, up 3.7 percent compared to 1995 [7]. Total EIC rose \$3.3 billion, or 13.3 percent, to \$28.2 billion for 1996 [8]. The 1996 annual growth rate of the earned income credit amount fell by comparison to the 24.5-percent annual growth for 1995. The most significant increase for 1996 returns claiming the EIC occurred on those returns with two or more qualifying children (Figure E). The number of EIC returns that fell into this category grew by 8.6 percent, and the amount of EIC claimed on these returns increased 24.3 percent, from \$13.2 billion to \$16.5 billion.

The stronger relative growth in both the number of EIC returns and the EIC amount for taxpayers with two or more eligible children compared to those with just one child was primarily the result of the final "phase-in" of tax law changes contained in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) (see the 1996 Tax Law changes section in this article for a more in-depth explana-

Individual Income Tax Returns, 1996: Early Tax Estimates

Figure E

Comparison of Earned Income Credit (EIC), Tax Years 1995 and 1996

[Number of returns is in thousands--money amounts are in millions of dollars]

Item	1995 ETE ^{1,2}		1996 ETE ¹		Percentage increase in amount
	Number of returns	Amount	Number of returns	Amount	
	(1)	(2)	(3)	(4)	(5)
Total earned income credit (EIC) ³	18,404	24,879	19,092	28,197	13.3
EIC on returns with no qualifying children.....	3,238	567	3,410	636	12.2
EIC on returns with one qualifying child.....	7,949	11,082	7,841	11,111	0.3
EIC on returns with two or more qualifying children.....	7,217	13,230	7,841	16,450	24.3
Refundable earned income credit (EIC).....	14,617	20,286	15,145	22,874	12.8
EIC on returns with no qualifying children.....	2,133	404	2,274	446	10.4
EIC on returns with one qualifying child.....	6,329	8,744	6,185	8,622	-1.4
EIC on returns with two or more qualifying children.....	6,155	11,139	6,686	13,805	23.9

¹ Data are based on the Early Tax Estimates (ETE) subsample of returns used for Statistics of Income--Individual Income Tax Returns.

² 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

³ For SOI tabulations, the earned income credit is divided into three parts: an amount used to offset income tax before credits (limited to the amount needed to reduce income tax after credits to zero); an amount used to offset all other taxes (limited to the amount needed to reduce total tax liability to zero); and a refundable portion (the excess of credit over total taxes).

NOTE: All data are for returns filed through April.

tion of these changes). The credit percentage used to compute the EIC for taxpayers with one qualifying child reached its permanent level in 1995. However, OBRA '93 provided one more year of substantial increase in the credit percentage for taxpayers with two or more qualifying children before setting the permanent level in 1996. While the maximum credit for taxpayers with one qualifying child only increased (for inflation) by 2.8 percent, from \$2,094 to \$2,152, the maximum amount of EIC allowed for taxpayers with two or more qualifying children increased 14.3 percent, from \$3,110 to \$3,556 for 1996. The differential between these two categories of EIC qualification was further widened by an unequal expansion of the income eligibility level for claiming the EIC. The "ceiling" for earned income, below which a taxpayer with two or more qualifying children could claim the EIC, grew 6.8 percent for Tax Year 1996 to \$28,495. This increased income eligibility level allowed more taxpayers with two or more qualifying children to take advantage of the EIC, resulting in a relatively larger increase in the number of EIC returns in this category. For taxpayers with only one eligible child, the income ceiling to qualify for the EIC increased (for inflation) by less than half (2.8 percent) to \$25,078, hence, the smaller growth in the number of EIC returns with one qualifying child.

In contrast to the decline in growth of the number of EIC returns for taxpayers with no eligible children for 1995, the number of returns in this category for 1996 grew

by 5.3 percent. Similarly, the amount of credit claimed by these taxpayers grew 12.2 percent to \$0.6 billion, reversing the declining growth of the previous year.

Unlike other tax credits, the EIC not only offsets income tax before credits (as well as certain additional income-related taxes), but refunds any portion of the credit that exceeds these taxes. The refundable amount of EIC comprises the largest segment of the EIC, totaling \$22.9 billion for 1996, up 12.8 percent from the \$20.3 billion reported the previous year.

Total tax credits, which include the EIC to the extent that it was used to offset income tax before credits, rose by 12.5 percent to \$8.0 billion for Tax Year 1996 (Figure D). The EIC and the child care credit are the two largest components of the total tax credits, accounting for more than 73.0 percent of 1996 total tax credits. However, while EIC used to offset income tax before credits increased 17.0 percent to \$3.5 billion, 1996 child care credits decreased slightly, 0.5 percent, to \$2.3 billion. Table 5 provides more detailed data on tax credits, as well as statistics describing selected deductions, taxes, and tax payments, classified by size of adjusted gross income.

Filing Patterns and Characteristics of Returns

The IRS projected the total number of returns to be filed for Tax Year 1996 at 120.6 million (Figure F). As of May 2, 1997, when the sampling of tax returns for Tax Year 1996 ETE was completed, 111.7 million returns had been filed with the IRS, up 1.0 percent compared to 1995. The

Individual Income Tax Returns, 1996: Early Tax Estimates

Figure F

Number of Returns Filed, Tax Years 1989 to 1996

[Number of returns is in thousands]

Returns filed	Returns filed for tax year:							
	1989	1990	1991	1992	1993	1994	1995 ¹	1996
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Returns filed through April of the filing year.....	104,314	106,465	107,140	106,262	106,769	107,291	110,587	111,694
Returns filed through December of the filing year.....	112,136	113,470	113,795	113,754	114,602	115,943	118,218	120,624 ²
Returns filed through April as a percentage of returns filed through December.....	93.0	93.8	94.2	93.4	93.2	92.5	93.5	92.6 ³

¹ 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

² Projected total by IRS Research Division of Forms 1040, 1040A, 1040EZ, including electronically filed returns.

³ Estimated on the basis of projections for Tax Year 1996.

Figure G

Returns Filed through April of the Filing Year, by Tax Form Used, Tax Years 1989 to 1996

[Number of returns is in thousands]

Form used	Tax year							
	1989	1990	1991	1992	1993	1994	1995 ¹	1996
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
All returns ².....	104,314	106,465	107,140	106,262	106,769	107,291	110,587	111,694
Traditional paper returns.....	100,047	97,835	94,940	89,854	89,273	92,921	88,705	84,725
Form 1040.....	63,533	60,190	58,650	54,287	53,856	55,998	54,014	53,964
Form 1040A.....	17,677	20,860	19,430	19,652	18,218	19,502	18,122	16,722
Form 1040EZ.....	18,837	16,785	16,860	15,915	17,199	17,421	16,569	14,039
Electronically-filed returns (1040 ELF) ³	4,267	8,705	10,795	12,459	13,441	11,729	14,872	19,007
TeleFile.....	N/A	N/A	N/A	N/A	N/A	720	2,818	4,663
Form 1040PC.....	N/A	N/A	1,405	3,951	4,055	2,641	6,777	7,962
	Percentage of returns							
All returns.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Traditional paper returns.....	95.9	91.9	88.6	84.6	83.6	86.6	80.2	75.9
Form 1040.....	60.9	56.5	54.7	51.1	50.4	52.2	48.8	48.3
Form 1040A.....	16.9	19.6	18.1	18.5	17.1	18.2	16.4	15.0
Form 1040EZ.....	18.1	15.8	15.7	15.0	16.1	16.2	15.0	12.6
Electronically-filed returns (1040 ELF) ³	4.1	8.2	10.1	11.7	12.6	10.9	13.4	17.0
TeleFile.....	N/A	N/A	N/A	N/A	N/A	0.7	2.5	4.2
Form 1040PC.....	N/A	N/A	1.3	3.7	3.8	2.5	6.1	7.1

¹ 1995 ETE data published in this article do not match those of last year's article because 1996 ETE data were produced one week later in the year than 1995 ETE data. Therefore, 1995 ETE data were rerun for this article to include one extra week of data to facilitate a more accurate comparison.

² For Tax Year 1995, includes 233 Form 1040T returns, not shown separately because the Form 1040T has been discontinued.

³ Includes TeleFile returns, shown separately.

N/A - Not applicable.

NOTES: Detail may not add to totals because of rounding. All data are for returns filed through April.

number of returns filed through May 2, as a percentage of the total number of returns projected for Tax Year 1996, was 92.6 percent, down 0.9 percentage points from the previous year [9].

For the second consecutive year, the number of returns filed using traditional "paper" methods declined, while the number of returns filed using alternative methods continued to show a marked increase (Figure G). For 1996, the number of traditional paper returns filed was 84.7 million, a 4.5-percent decline from the previous year. The number

of Forms 1040 fell only slightly (less than 0.1 percent), and Forms 1040A fell 7.7 percent. The number of Forms 1040EZ fell the most, dropping 15.3 percent. The decline in the number of paper Forms 1040EZ filed can be primarily attributed to taxpayers who changed their methods of filing from using a "paper" Form 1040EZ to using the TeleFile reporting method. A TeleFile return is a Form 1040EZ equivalent that is filed over the telephone.

For 1996, the number of returns filed using alternative methods (Form 1040PC and electronic filing, including

Individual Income Tax Returns, 1996: Early Tax Estimates

TeleFile) reached approximately 27.0 million, an increase of 24.6 percent, and accounted for 24.1 percent of all returns. The alternative filing method with the largest annual increase was electronic filing (ELF), which rose 27.8 percent and represented 17.0 percent of all returns filed. Of the 19.0 million returns that were filed electronically, nearly 4.7 million were TeleFile returns. For 1996, the second year that TeleFile was available nationwide, its use grew by 65.5 percent. Excluding the TeleFile returns, ELF returns still grew 19.0 percent, a little more than double the rate of growth from the previous year.

In addition, filing of the Form 1040PC, an IRS-approved computer format that allows the taxpayer to print out only those items for which he or she provides information, grew considerably for the fourth time since being introduced for 1991 [10]. For 1996, the number of Forms 1040PC rose 17.5 percent, from 6.8 million to 8.0 million returns. The prevalence of home computers, the growing popularity of tax software packages, and Form 1040PC filing by tax preparation firms are some of the reasons behind this continued growth. For a detailed breakdown of the various filing methods, by AGI size and filing status, see Table 1. For information regarding the number of selected forms and schedules filed with the different form types, see Table 7.

Summary

Early estimates for Tax Year 1996 indicate that the growth of both adjusted gross income (AGI) and taxable income (6.6 and 7.9 percent, respectively) outpaced the 3.0-percent annual rate of inflation. In addition, the growth of total tax for 1996 tripled the annual inflation rate by rising 9.0 percent to \$539.0 billion. The 1996 filing period saw a 4.5-percent decline in traditional "paper" methods of filing (Forms 1040, 1040A, and 1040EZ). Conversely, alternative methods of reporting (Form 1040PC and electronic filing, including TeleFile) saw a continued growth, increasing by a combined 24.6 percent.

The earned income credit (EIC) demonstrated continued growth, rising 13.3 percent to \$28.2 billion for 1996. The growth in EIC was fueled primarily by the final major expansion in OBRA '93 of the earned income ceiling and the maximum amount of EIC that can be claimed by taxpayers with two or more qualifying children. Further, the number of taxpayers claiming the EIC grew by 3.7 percent to 19.1 million for 1996.

1996 Tax Law Changes

Standard deductions, personal exemptions, tax rate bracket boundaries, and the earned income credit are all indexed, as required by Federal tax law, to avoid their

erosion by inflation. Without indexing, annual increases in inflation would diminish the real value of these items.

The following is a list of Federal tax law changes and IRS administrative changes that had a major impact on the 1996 Early Tax Estimates presented in this article:

Earned Income Credit.--As with previous years, the maximum earned income credit increased, as did the amount of "earned income" and AGI an individual could have and still claim the credit. For taxpayers with one qualifying child, the maximum credit was \$2,152, up from the maximum credit of \$2,094 for Tax Year 1995. For taxpayers with two or more qualifying children, the maximum credit increased to \$3,556, up from \$3,110 for Tax Year 1995. The maximum credit for taxpayers with no qualifying children increased to \$323 from \$314. To be eligible for the credit, the taxpayer's "earned income" and AGI had to be less than \$25,078 (\$24,396 for 1995) with one qualifying child, or less than \$28,495 (\$26,673 for 1995) with two or more qualifying children. For those without a qualifying child, earned income and AGI had to be less than \$9,500, compared to \$9,230 for 1995. The definition of AGI used for the earned income credit was modified for Tax Year 1996 per the Revenue Provisions of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. For EIC purposes, modified AGI does not include the following losses: net capital losses, net losses from trusts and estates, net losses from nonbusiness rents and royalties, and 50 percent of net losses from businesses. The legislation mentioned above also added a new eligibility requirement for the EIC. For 1996, taxpayers with investment income totaling more than \$2,200 were not eligible to receive the EIC. For most people, investment income includes interest (taxable and tax-exempt), dividend income, and capital gain net income.

Standard Deductions.--For Tax Year 1996, the basic standard deduction increased for each filing status. Standard deductions rose to \$4,000; \$5,900; \$6,700; and \$3,350, for a single person, for a head of household, for married persons filing jointly or a qualifying widow(er), and for married persons filing separately, respectively. By comparison, Tax Year 1995 standard deductions were \$3,900; \$5,750; \$6,550; and \$3,275, respectively. The basic standard deduction claimed by filers who were dependent children of other taxpayers remained at \$650 for 1996. The additional standard deductions for the aged and blind rose to \$1,000 for single and head of household filers, and to \$800 for married persons filing jointly, married persons filing separately, and qualified widow(er)s, up from \$950 and \$750, respectively, for 1995.

Individual Income Tax Returns, 1996: Early Tax Estimates

Itemized Deductions.--As for previous years, itemized deductions were limited for some high-income taxpayers based on AGI. For Tax Year 1996, the AGI threshold for the limitation increased to \$117,950 from \$114,700 for all filers, except married persons filing separately, for whom it increased to \$58,975 from \$57,350. The limitation did not apply to deductions for medical and dental expenses, "investment interest" expenses, casualty or theft losses, and gambling losses. To arrive at allowable itemized deductions, total itemized deductions were reduced by the smaller of: a) 80 percent of the "non-limited" deductions, or b) 3 percent of the amount of AGI in excess of the AGI threshold.

Personal Exemptions.--Like standard and itemized deductions, the amount allowed for personal exemptions also increased for Tax Year 1996. For each qualified exemption, a filer could deduct \$2,550, up from \$2,500 for Tax Year 1995. Detailed data on exemptions, classified by size of AGI, are presented in Table 6.

Social Security Numbers.--Taxpayers were required to provide the Social Security number for each dependent claimed on their tax returns, for each qualifying person for the child and dependent care credit, and for each qualifying child listed on the Schedule EIC (filed by earned

income claimants), unless the child was born in December 1996.

Self-employment Tax.--The maximum "net earnings" subject to the Social Security tax portion of the self-employment tax (12.4 percent) increased to \$62,700 from \$61,200. In addition, all "net earnings" of at least \$400 (\$108.28 for church employees) were subject to the Medicare tax portion (taxed at 2.9 percent of the earnings).

Tax Brackets.--Tax rates remained unchanged at 15, 28, 31, 36, and 39.6 percent, but the tax bracket boundaries increased because of inflation indexing (Figure H).

Data Sources and Limitations

The statistics presented in this article were derived from a sample of all individual income tax returns received in the ten IRS service centers from January 2 through May 2, 1997 [11]. The sample was selected based on the primary Social Security number (SSN) (i.e., the SSN of the "primary" or first listed taxpayer in the case of joint returns) ending in one of two pre-defined orders of the last four digits. Two numbers between 0000 and 9999 were chosen, and all return SSN's ending in one of these two numbers were sampled. Electronically-filed returns with a

Figure H

Marginal Tax Rates, by Filing Status, for Tax Years 1995 and 1996

Marginal tax rate	Filing status			
	Single		Married filing jointly or qualifying widow(er)	
	1995	1996	1995	1996
	Taxable income range	Taxable income range	Taxable income range	Taxable income range
	(1)	(2)	(3)	(4)
15 percent.....	Under \$23,351	Under \$24,001	Under \$39,001	Under \$40,101
28 percent.....	\$23,351 to \$56,550	\$24,001 to \$58,150	\$39,001 to \$94,250	\$40,101 to \$96,900
31 percent.....	\$56,551 to \$117,950	\$58,151 to \$121,300	\$94,251 to \$143,600	\$96,901 to \$147,700
36 percent.....	\$117,951 to \$256,500	\$121,301 to \$263,750	\$143,601 to \$256,500	\$147,701 to \$263,750
39.6 percent.....	\$256,501 or more	\$263,751 or more	\$256,501 or more	\$263,751 or more
Marginal tax rate	Filing status--continued			
	Married filing separately		Head of household	
	1995	1996	1995	1996
	Taxable income range	Taxable income range	Taxable income range	Taxable income range
	(5)	(6)	(7)	(8)
15 percent.....	Under \$19,501	Under \$20,051	Under \$31,251	Under \$32,151
28 percent.....	\$19,501 to \$47,125	\$20,051 to \$48,450	\$31,251 to \$80,750	\$32,151 to \$83,050
31 percent.....	\$47,126 to \$71,800	\$48,451 to \$73,850	\$80,751 to \$130,800	\$83,051 to \$134,500
36 percent.....	\$71,801 to \$128,250	\$73,851 to \$131,875	\$130,801 to \$256,500	\$134,501 to \$263,750
39.6 percent.....	\$128,251 or more	\$131,876 or more	\$256,501 or more	\$263,751 or more

Individual Income Tax Returns, 1996: Early Tax Estimates

primary SSN ending in one of these two four-digit combinations were also included. The same SSN endings have been used every year since 1979. This method of sampling provides results similar to those produced from a random sample. The returns studied for ETE statistics are a subset of the returns included in the sample used for *Statistics of Income -- 1996, Individual Income Tax Returns*.

Since two SSN endings out of a possible 9,999 were selected, each return represented approximately 1 out of 5,000 returns in the population. The size of the entire ETE sample from January 2 through May 2, 1997, was 21,297 returns. Sample weights were adjusted to compensate for returns identified as missing from the sample.

Because the data presented in this article are estimates based on a sample, they are subject to sampling (as well as non-sampling) error. Non-sampling error will be higher for ETE data than for other SOI data because approximately 10 percent of the returns included had not yet been subjected to any of the regular IRS returns processing

steps, which would have identified and corrected many taxpayer reporting errors. Such returns show a tax due at time of filing and are typically processed after April 15 so that refund returns can be given priority. Sample returns with a tax due were identified when they were received at the IRS centers and forwarded for SOI processing prior to regular administrative processing. During SOI processing, these returns were tested for internal consistency, and the more obvious taxpayer omissions and math errors were corrected for the statistics.

Figure I presents estimated coefficients of variation (CV's) for the number of returns and money amounts for selected income items. The reliability of estimates based on samples, and the use of CV's for evaluating the precision of estimates based on samples, are discussed in the appendix to this issue of the *Bulletin*.

Notes and References

- [1] The ETE data for Tax Year 1996 were produced one week later in the year than the data for Tax Year

Figure I

Coefficient of Variation for Selected Items, Tax Year 1996

[Number of returns is in thousands--money amounts are in millions of dollars--coefficients of variation are percentages]

Item	Number of returns	Coefficient of variation	Amount	Coefficient of variation
	(1)	(2)	(3)	(4)
Adjusted gross income (less deficit).....	111,694	N/A	3,972,391	3.09
Salaries and wages.....	96,391	0.27	3,039,872	1.27
Taxable interest.....	60,783	0.57	135,620	8.68
Capital gain distributions reported on Form 1040.....	4,800	3.30	5,508	10.48
Taxable Individual Retirement Arrangement (IRA) distributions.....	5,267	3.15	39,738	7.09
Taxable pensions and annuities.....	18,167	1.53	211,419	2.50
Partnership and S Corporation:				
Net income.....	2,778	4.45	126,904	20.35
Net loss.....	1,704	N/A	17,166	19.24
Unemployment compensation.....	7,532	2.54	17,649	3.60
Social security benefits in adjusted gross income.....	6,321	2.85	43,699	3.83
Total statutory adjustments.....	15,121	1.70	30,551	5.10
Individual Retirement Arrangement (IRA) payments.....	3,961	3.62	7,549	4.19
Moving expenses.....	714	8.55	1,115	12.64
Deduction for self-employment tax.....	10,341	2.13	9,151	4.21
Self-employed health insurance deduction.....	2,102	5.20	1,802	6.51
Total itemized deductions.....	30,587	1.00	483,853	4.81
Taxes paid deduction.....	30,139	1.02	167,950	3.14
Total interest paid deduction.....	25,855	1.15	190,246	1.64
Contributions deduction.....	27,413	1.10	85,618	26.25
Standard deductions.....	80,224	0.39	407,359	0.48
Total exemptions.....	101,100	0.21	553,664	0.45
Taxable income.....	89,147	0.33	2,629,590	3.85
Total earned income credit ¹	19,092	1.35	28,197	1.69
Total income tax ²	83,564	0.37	538,991	5.73

¹ Includes earned income credit used to reduce total income tax to zero, plus the amount used to offset any additional taxes; plus the refundable portion.

² Total income tax is the sum of income tax after credits and alternative minimum tax, less the total earned income credit as reported on the tax return (if the result was negative, total income tax was made equal to zero).

N/A - Not applicable.

NOTE: All data are for returns filed through April.

Individual Income Tax Returns, 1996: Early Tax Estimates

1995. In order to accurately compare the data for both tax years, the TY95 data were regenerated for this article, using a similarly later date. Therefore, TY95 ETE data published in this article will not match the data published in last year's Early Tax Estimates article. See Cronk, Daryl E. and Keenan, Maureen, "Individual Income Tax Returns, 1995: Early Tax Estimates," *Statistics of Income Bulletin*, Fall 1996, Volume 16, Number 2.
- [2] U.S. Department of Labor, Bureau of Labor Statistics, *Monthly Labor Review*. The consumer price index (CPI-U) represents annual averages of monthly figures and reflects buying patterns of all urban consumers (1982-84=100):
 1996 CPI-U = 156.9;
 1995 CPI-U = 152.4; and
 1994 CPI-U = 148.2.
- [3] Early tax estimates for capital gain distributions reported on Schedule D have not been tabulated. Final SOI data show that capital gain distributions reported on Schedule D grew 25.1 percent between 1994 and 1995, from \$8.6 billion for 1994 to \$10.7 billion for 1995.
- [4] "Financial Markets, Interest Rates," *Federal Reserve Bulletin*, June 1997, Volume 83, page A23.
- [5] The ETE sample only goes back as far as Tax Year 1992; therefore, preliminary data based on the more complete Statistics of Income sample were used to note the change in IRA payments for Tax Years 1986 through 1991. See Cruciano, Therese M., "Individual Income Tax Returns, Preliminary Data, 1994," *Statistics of Income Bulletin*, Spring 1996, Volume 15, Number 4.
- [6] Total income tax is the sum of income tax after credits (including the subtraction of the earned income credit) and the alternative minimum tax. If the result is negative, total income tax is limited to zero.
- [7] For Statistics of Income tabulations, the earned income credit is divided into three parts: an amount used to offset income tax before credits (limited to the amount needed to reduce income tax after credits to zero); an amount used to offset all other taxes (limited to the amount needed to reduce total tax liability to zero); and a refundable portion (the excess of credit over total taxes).
- [8] Section 1615 of the Small Business Act introduced a policy to "apply mathematical or clerical error procedures for dependency exemptions and filing status when correct taxpayer identification numbers are not provided." In short, the IRS was mandated to disallow the exemption or EIC for any dependent whose SSN was incorrect or absent. The taxpayer was then given 60 days to provide the correct SSN. If the taxpayer provided this information, the tax record was updated on the IRS's Integrated Data Retrieval System (IDRS). This article uses data posted *after* the IDRS tax record update and, therefore, reflects any changes to the tax records. Using data collected before the final IDRS update, the Earned Income Credit (EIC) increased roughly 10 percent. The IDRS update, however, brought the annual increase in EIC to 13.3 percent for 1996, as cited in this article.
- [9] Taxpayers could file after April 15, 1997, without any penalty if:
- (a) they lived outside the United States and Puerto Rico, and their main place of business or military post of duty was outside the United States and Puerto Rico (these taxpayers were permitted an automatic extension to June 16, 1997);
 - (b) they filed a Form 4868 for an automatic extension of the filing deadline, paying the estimated tax balance due with this form (these taxpayers were permitted an automatic extension to August 15, 1997); or
 - (c) they filed a Form 2688 for an additional extension of time to file (these taxpayers were granted an extension of 2 or more additional months, provided that there was a good reason why the previous 4-month extension was inadequate).
- [10] Form 1040PC returns are computer-generated returns that present only line numbers and data entries. Only those lines of the tax form for which the taxpayer has an entry appear on Form 1040PC, resulting in a return with fewer pages than if the same return had been prepared using the standard IRS tax forms and schedules.
- [11] The ETE sample was derived from the following types of individual tax returns: Form 1040, Form 1040A, Form 1040EZ, Form 1040PC, and electronically-filed returns, including TeleFile returns.